

***United States Court of Appeals  
for the Second Circuit***



**APPELLANT'S  
BRIEF**



POINT III

SUFFICIENT APPROVAL OF A RENT INCREASE, BASED ON INSUFFICIENT AND INCOMPLETE EVIDENCE, WAS ERRONEOUS AND SHOULD BE REVERSED.

In return for a 3%, below-market rate mortgage subsidy and FHA mortgage insurance, Grace HDFC agreed, in accordance with the statute, to regulation of rents by the Secretary to "effectuate the purposes of [§ 221(d)(3)]", which the Court in Marshall found was to benefit low-income tenants. Marshall v. Lynn, 497 F. 2d 643, 647 (D.C. Cir. 1973), Cert. den., -U.S. - (1974). To carry out this duty, HUD has promulgated regulations, 24 C.F.R. §§ 221.501 et seq. governing the application for increase and criteria for approval or disapproval. § 221.531(c) requires that the agency must take into consideration the need to provide "reasonable rentals" to the project's low and moderate income tenants, together with the "income necessary to maintain the economic soundness of the project."

Pursuant to its regulations, in this case, HUD determined, on the basis of an ex parte submission, that Grace HDFC was entitled to a 23% rent increase. HUD's approval was an agency action within the meaning of 5 U.S.C. § 551(13). Langevin v. Chenango Court, Inc., 447 F. 2d 296, 303 (2d Cir. 1971). Such action, under the Administrative Procedure Act, 5 U.S.C. 701 is subject to judicial review except where there is a statutory

prohibition on review, or where "agency action is committed to agency discretion by law."

Since there is no showing in the § 221(d) (3) enabling statute, 12 U.S.C. § 1715 1 of a clear and convincing legislative intent to restrict access to judicial review, and since the same statute was patently not "drawn in such broad terms that in a given case there is no law to apply," review will lie. Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 410 (1971).

Scope of review, however, is determined according to 5U.S.C. § 706 (2) which provides that a reviewing court shall "hold unlawful and set aside agency action, findings and conclusions found to be" in violation of its provisions. HUD's action with respect to this increase falls within the standards of 5 U.S.C. § 706(2).

A. Grace HDFC's Application was on its Face Insufficient to Warrant Approval.

In the case of Grace HDFC, a not-for-profit corporation whose sole asset is the Grace Towers project, and whose sole corporate purpose is to provide housing to low income families, HUD in considering any application for rental increase, must exclude from its calculations any profit or return on investment and may consider only valid operating expenses in determining



economic need.\*

Plaintiffs received from FHA, in response to their request, copies of all of Grace HDFC's materials in support of the increase application.\*\* These were submitted to the certified public accounting firm of Hoffberg, Oberfest & Berger, which is experienced in accounting, auditing and management of federally subsidized housing developments.

On examination, the materials were found to be so insufficient that the accountants were completely unable to express an opinion as to whether any increase was justified. (Affidavit of Stanley Berger, Esq., C.P.A., a partner in the firm, annexed as Exhibit 7 to Complaint (A 328-329). Several critical omissions were found, including lack of proper fuel, electric and gas bills, lack of data personnel and maintenance costs and lack of rent roll information. (A 328-329). \*\*\*

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\* The sponsor, of course, may not circumvent the statutory required against received profits or returns on investment by providing its own management and then paying corporation board members an unlawful profit. New York Not-for-Profit Corporation Law § 515(a) (McKinney's Vol. 37) In the instant case as set forth in the affidavit of Elizabeth Boone, paragraphs 13 and 14 (A 118), Grace HDFC's Secretary, defendant Underwood, is apparently head of the management operation, and upon information and belief members of Grace HDFC's board of directors are also paid employees of said operation. Any salary or compensation received by them and not provided for in the Articles of Incorporation or in the by-laws would be in violation of law. N.F.P.C. Law § 515(b).

\*\* Copies of letters exchanged with FHA and of the materials are reproduced as Exhibits 5 and 6 to the Complaint (A 284-326).

\*\*\* The accountant stated that a copy of Grace HDFC's management agreement(s) and certified annual financial statements would also be required for a proper and complete analysis. (A-329).

Without this information, therefore, HUD lacked the substantial evidentiary foundation necessary for a rational determination of the economic need of Grace HDFC, as well as of the "reasonableness" of the rentals, after a 23% increase, for low and moderate income tenants. This falls short of the test of "substantial evidence" (5 U.S.C. § 706(2)(B)): "...such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." Noble Drilling Corporation v. Donovan, 266 F. Supp. 917, 926 (E.D. La 1967); Universal Camera Corp. v. N.L.R.B., 340 U.S. 474, 490 (1951). This standard goes to the reasonableness of what the agency did on the basis of the evidence before it. J.A. Terteling & Sons, Inc. v. U.S., 390 F. 2d 926, 931 (Ct. Cl. 1968). Judicial review under the substantial evidence requirement is authorized when agency action is based as here, on an adjudicatory hearing, (i.e. Grace HDFC's ex parte submission to HUD and its determination). 5 U.S.C. 556, 557, Citizens to Preserve Overton Park, supra, 401 U.S. at 414. Use of such incomplete information as the basis of its decision goes clearly beyond the discretion of the agency, and certainly is not a determination rationally related to the standards the agency is presumably applying, so that the decision likewise violates 5U.S.C. § 706 (2) (A) (decisions which are arbitrary, capricious or abuse of discretion subject to reversal.) Id.at 415.

B. Information Improperly Withheld From FHA, Which Plaintiffs Would Submit at a Hearing, Warrants Denial of the Increase.

The Secretary's approval of the rent increase was



justified, not simply because the application did not establish a sufficient basis for it, but still further because additional information, which defendants Grace HDFC, Underwood and Evans (so far as plaintiffs know) failed to give to FHA, shows that the project has additional income, and is in numerous ways deficient in services and in violation of FHA regulations,

i) Additional Income

As set forth in plaintiffs' complaint and affidavits, tenants of Grace Towers have been required to pay fees for rental of apartments in the project, for transfers between apartments within the project, for parking spaces in the parking lot, for use of the community room, and for repairs. There is also a coin-operated laundry in the basement. (A 111-112) Plaintiffs do not claim to know the full extent or amounts of such charges, but they apparently are frequent practices. Insofar as plaintiffs know, these were never reported to FHA as income. This is a clear violation of 24 C.F.R. § 221.542(a), requiring an accounting to the Commissioner for all income.\* Additional income of course, reduces the need for an increase.

ii) Substandard Conditions

The physical conditions of Grace Towers fall far short of FHA's requirements, and in some instances, are distinctly

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\* It appears that no approval has been given by FHA for the imposition of these charges, through approval of a lease or otherwise. This violates 24 C.F.R. § 221.530(a) which prohibits unsanctioned charges.

hazardous. As detailed in plaintiffs complaint and affidavits, the project suffers from hazardous and inadequate wiring, roof leaks, causing damages to some tenants apartments, and inadequate heat in some apartments all this in a project less than four years old (A 117-118). \*

These shortcomings are in violation of state and local law, which also serve as standards for HUD for buildings with FHA mortgage insurance. 5 U.S.C. § 1715 1 (d) (2); 24 C.F.R. § 221.545(c). Furthermore, they violate plaintiffs' rights under their leases. Most significantly, however, full performance of these obligations, lacking here, is a pre-requisite for FHA approval of any increase in rents. 5 U.S.C. § 706 (2) (A), (B), (D), (E): 24 C.F.R. § 221.545(c). And see Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 415-419 (1971).

Assuming that all plaintiffs' allegations regarding sub-standard conditions were true, as the District Court was required to do when it decided defendants' motions for summary judgment, it erred in granting their application in that Grace HDFC had not met another prerequisite of HUD approval of the increase, that the mortgagor keep the project in good repair. 24 C.F.R. § 221.530(b), 221.545(c); Bloodworth v. Oxford Village Townhouses, Inc. 377 F. Supp.709, 720-721 (N.D. Ga. 1974).

All of the foregoing shows the flagrant manner in which the requirements of FHA have been flouted, chiefly by withholding required information. Plaintiffs believe nevertheless that this is only the tip of the iceberg, and that given opportunity, much

\* Plaintiffs were also, as an inducement to renting apartments, given promises of other services, never in fact provided, on which they feel entitled to rely. These include guard services, a playground, and gates on ground floor windows.

more can be shown. But this alone is sufficient to show that the increase here results from violations of HUD's own regulations and should be set aside by this Court.\*

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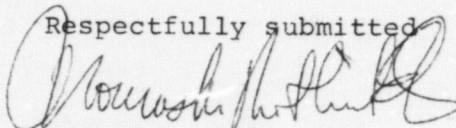
\* It should be noted that because there have been no formal findings by HUD regarding the increase (A 301 See also 285-287), should this Court reverse, requiring the agency to make a full determination in case of appeal the District Court would have to review "Critically" the agency's explanation, since it will be to some extent a "post hoc rationalization". Citizens to Preserve Overton Park, supra at 420.



CONCULSION

For all the foregoing reasons, plaintiffs request that this Court reverse the judgment of the District Court and grant the injunctive and declaratory relief sought herein.

Respectfully submitted



THOMAS N. ROTHCHILD  
Attorney for Plaintiffs

ON THE BRIEF:

Thomas N. Rothschild  
Igou M. Allbray, Law Clerk

UNITED STATES COURT OF APPEALS  
SECOND CIRCUIT

GRACE TOWERS TENANTS' ASS'N, et al.,

Plaintiff-Appellants,

-against-

GRACE HOUSING DEVELOPMENT FUND  
CO., INC., etc., et al.,

Defendant-Appellees.

AFFIDAVIT OF  
SERVICE

CIVIL APPEAL

DOCKET NO.  
75-7214

STATE OF NEW YORK)  
COUNTY OF KINGS ) ss.:

IGOU M. ALLBRAY, being duly sworn deposes and says that he is over eighteen years of age and not a party to this action, that he served the Brief and Appendix on Appeal upon James T. Lynn, Secretary of HUD, a Defendant-Appellee herein ~~depositing with the U.S. Post Office by certified mail~~ by ~~delivering~~ a set of these papers to the U.S. Attorney for the Eastern District of New York, Lewis F. Tesser, Ass't U.S. Attorney of Counsel, at his offices at 225 Cadman Plaza East, Brooklyn, New York on ~~May~~ <sup>June 2</sup>, 1975, and upon Defendant-Appellees Grace HDPC, Underwood and Evans by ~~delivering~~ <sup>depositing with the U.S. Post Office by certified mail</sup> a set of these papers upon their attorneys, Greener and Ostro, One Penn Plaza, New York, New York, on ~~May~~ <sup>June 2</sup>, 1975, said attorneys being authorized by said defendants to accept service of papers on their behalf.

SWORN to Before Me  
this 2 day of

IGON M. ALLBRAY

NOTARY PUBLIC